89-1794
No.

IN THE

Supreme Court of the United States

OCTOBER TERM, 1989

GERALD L. SCHULMAN,
Petitioner,
vs.
UNITED STATES OF AMERICA,
Respondent.

ON PETITION FOR WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

PETITION FOR WRIT OF CERTIORARI

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QUESTIONS PRESENTED

1. Whether a federal Court of Appeals, in reviewing the sufficiency of an indictment, may direct the trier of fact in the District Court to find facts which have the effect of requiring the District Court, against its expressed will, to convict the accused.

A. Whether Due Process of Law is offended when a federal district judge, sitting as trier of fact in a criminal case, states that but for such directions she would have found the accused not guilty.

B. Whether this Court, in its supervisory role over the lower federal courts, should correct a departure from the accepted and usual course of judicial proceedings where a federal Court of Appeals, prior to trial, usurps the District Court's power and duty to find the facts in the first instance.

2. Whether Due Process of Law is offended when a federal district court, sitting as trier of fact in a criminal action, returns a finding of guilty notwithstanding the court's expressed reasonable doubts as to the guilt of the defendant.

3. Whether, when a defendant's business practices raise novel questions of tax liability to which governing law offers no clear guidance, he can be required to stand trial in a federal *criminal* proceeding consistent with his Due Process right of fair notice merely because the government asserts in conclusory terms that all taxpayers are on notice that sham transactions are illegal.

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PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

Petitioner prays that a writ of certiorari issue to review the judgments of the Ninth Circuit Court of Appeals entered in this case.

OPINIONS BELOW

The United States Court of Appeals for the Ninth Circuit affirmed the conviction of Petitioner for conspiracy and tax fraud in violation of 18 U.S.C. §371 and 26 U.S.C. §7206(1) on November 15, 1989 in an unpublished opinion. The opinion (hereinafter *Schulman II*) is reproduced in Appendix A, *infra*. The Court of Appeals denied Petitioner's petition for rehearing on February 14, 1990. The order denying rehearing is reproduced in Appendix B, *infra*.

The judgment of the United States District Court for the Central District of California which was affirmed by the Ninth Circuit Court of Appeals is reproduced in Appendix C, *infra*.

Prior to the trial which resulted in the aforementioned judgments, the District Court had dismissed the indictment in a memorandum and order filed July 31, 1986. The order is reproduced in Appendix D, *infra*.

The United States Court of Appeals for the Ninth Circuit had reversed the dismissal in an opinion filed May 20, 1987 and reported at 817 F.2d 1355 (9th Cir. 1987). The opinion (hereinafter *Schulman I*) is reproduced in Appendix E, *infra*. Petitioner sought a writ of certiorari to review this nonfinal order, but the petition was withdrawn and dismissed pursuant to Rule 53. *Schulman v. United States*, 483 U.S. 1042 (1987).

This petition for a writ of certiorari seeks review of both of the foregoing opinions of the Ninth Circuit.

JURISDICTION

The opinion of the United States Court of Appeals for the Ninth Circuit was dated November 15, 1989. The Court of Appeals denied Petitioner's petition for rehearing on February 14, 1990. A suggestion for rehearing en banc was also denied on the same date.

The jurisdiction of this Court to review the judgment of the Ninth Circuit is invoked under 28 U.S.C. §1254(1).

CONSTITUTIONAL PROVISIONS AND STATUTES

The constitutional provisions and statutes involved in this case are the Fifth Amendment to the United States

Constitution, set forth in Appendix F, *infra*, and Title 26 U.S.C. §7206(1) and (2), set forth in Appendix G, *infra*.

STATEMENT OF THE CASE

Petitioner was convicted of criminal conspiracy and tax fraud following a bench trial by a reluctant federal district judge who stated on the record that she felt the court of appeals, in reversing her previous dismissal of the indictment, had "virtually dictated finding [Petitioner] guilty" and that if the court of appeals had not characterized the transaction alleged in the indictment in the manner in which it had, "I believe the court would have found him not guilty." As a result, Petitioner was convicted by a trier of fact which, in the words of the dissenting judge on the Court of Appeals, "did not feel free to consider whether the actual evidence warranted particular legal consequences, i.e., a finding of not guilty."

Petitioner Gerald Schulman was indicted in 1986 for conspiracy, making and subscribing and aiding in the preparation of false tax returns in violation of 18 U.S.C. §371, 26 U.S.C. §7206(1) and (2), and perjury in violation of 18 U.S.C. §1623. The indictments were based upon Petitioner's organization and promotion, from 1978 "up to and including the present," of ninety-one separate California real estate limited partnerships ("the Partnerships"), each of which had acquired a building in the United States under long-term lease to the U.S. Postal Service, public utilities or state and local governments ("Leased Properties").

The Partnerships were capitalized with approximately twenty-five million dollars ($25,000,000) in cash contributed by investors in the United States. The capital contributions were paid out by the Partnerships in due course for interest incurred on short-term loans obtained to facilitate the acquisition of low-interest,

purchase money mortgages for the Leased Properties and were reported as interest deductions on 1979 federal income tax filings.

The twenty-five count first superseding indictment charged, *inter alia*, that the short-term loans could not be recognized properly for tax purposes because they were generated in a "circular financing" transaction whereby the proceeds of a loan to the first of the Partnerships were ultimately deposited back to the lender in a pre-arranged back-to-back financing package. Thereafter, the lender extended credit to the succession of Partnerships in a similar fashion and completed loans totalling $252 million. The interest paid on those loans a year later equalled the amount of the capital contributed by Petitioner's limited partners, yielding a conservative 1:1 tax write-off for each of the investors. The indictment charged that Petitioner knew in 1978 and 1979 that it was criminal to deduct the interest because the transactions allegedly did not create *bona fide* indebtedness, even though the Government concedes that the interest actually was paid on the loans and the loans were repaid in a timely manner.

The District Court dismissed the charges in 1986, holding that Petitioner could not have had fair notice, as a matter of law, that the conduct charged was illegal at the time of the syndication of the real estate limited partnerships. The District Court found, without objection from the Government, that the Partnerships had real and substantial economic substance independent of any tax consequences; that the partnerships were capitalized with real money from independent investors; and that the money unquestionably was expended in connection with the acquisition of the Leased Properties.

Applying the law to these uncontested facts, the trial court sought to canvas any case law or administrative

precedent extant prior to the 1979 syndications that would support the Government's contention that the characterization of those expenditures as interest was clearly illegal. Judge Pfaelzer, however, found none. There existed no rule, regulation, statute or case precedent which clearly provided Petitioner with notice in 1979 that interest paid on indebtedness generated through circular financing with collected funds [1] was illegal.

Indeed, the court noted that in 1975, the government had unsuccessfully prosecuted Harry Margolis, the attorney who had advised and assisted Petitioner in setting up the Partnerships, for tax fraud on the same theory of sham circle transactions alleged in the prosecution of Petitioner. Another District Court had dismissed several of the counts against Margolis and a jury had acquitted Margolis of the remaining counts. Moreover, in 1986 (during the pendency of the alleged conspirac pleaded in the indictment against Petitioner), another District Court had again acquitted Margolis of criminal tax fraud in a prosecution based upon the same type of transaction and the same theory of sham circle transfers and worthless check swaps. That court had found "nothing illegal per se about sequential circular money transfers of the type used by the Margolis office in its tax planning." App. D at D-7 n.1.

Hence, the District Court concluded, "Schulman had reason to believe his activities were permissible and could not have had fair notice that his conduct was illegal.

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[1] The term "collected funds" means actual money on deposit with a bank which is available for payment upon demand. In a circular financing package or, indeed, in any back-to-back loan or loan with compensating balance requirements, collected funds are used in the dispersal of an initial loan. The funds are then deposited with the lender and are therefore available for extensions of credit to others.

Where, as in this case, an individual is not given fair notice of the requirements of the law, he necessarily lacks the requisite intent to violate the law." App. D at D-7.

Accordingly, the District Court held that Petitioner could not be fairly prosecuted for tax fraud for having reported the costs associated with such financing as "interest." Relying on *United States v. Dahlstrom*, 713 F.2d 1423 (9th Cir. 1983), *cert. denied*, 466 U.S. 980 (1984), the court wrote, "where, as in this case, an individual is not given fair notice of the requirements of law, he necessarily lacks the requisite intent to violate the law." *Id.*

On May 20, 1987, in *Schulman I*, the Court of Appeals for the Ninth Circuit reversed and found that Petitioner could have had due notice of the purported illegality of the tax shelter programs which he promoted in 1978 and 1979. The Court stated that it is "well settled that sham transactions are illegal," App. E. at E-8, and that "for an interest payment to be deductible, the interest must be paid on genuine indebtedness." *Id.*

Significantly, the Court of Appeals acknowledged that the ventures in question were fully and adequately capitalized with limited partner investments; that the ventures purchased and own "real buildings in the United States"; that the bulk of the buildings are currently leased to the United States Postal Service; and that, in fact, the ventures "had economic substance apart from their tax consequences." *Id.* at E-4. The Court also noted that the Government was not arguing that Petitioner, the limited partners or the Partnerships owned any of the entities involved in structuring the financing for the ventures,

which was complex and novel.[2] Finally, the Court of Appeals noted that each of the subject loans had been made with collected funds.

Nevertheless, the Court reversed and remanded the case for trial, reasoning that all taxpayers are necessarily charged with notice that sham transactions are illegal. The opinion is devoid of any reference to regulations, administrative decisions or case law from the period in question that could have provided any guidance to Petitioner with respect to the deductibility of the interest in the 1:1 tax shelter program that he was promoting in 1979.

The Court of Appeals' opinion concluded that "assuming the truth of the allegations in the indictment, the defendant was engaged in promoting a tax scheme, the illegality of which he had fair notice." App. E at E-12 - E-13.

Following remand, a three-day bench trial took place in the District Court in December 1987.[3] Throughout the trial and during subsequent proceedings, Judge Pfaelzer revealed her concern that the Court of Appeals had left little, if anything, for her to try. She noted that the Court of Appeals had stated that it agreed with the government that the Schulman financing transactions were a "sham that lacked substance", and asked what, in light of that

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[2] Indeed, one of the many stipulations of fact entered into by the Government was that neither Petitioner, the Partnerships nor the partners thereof had any direct or indirect ownership interest in any of the entities involved in the circular loan transactions.

[3] One reason the trial was so short was that the case was tried largely on the basis of lengthy factual stipulations. *See, e.g.*, note 2 hereto.

statement, was left to try.[4] The judge confessed that she had read the Court of Appeals opinion "about eight times and there are things in it that I simply don't understand"[5] and that the opinion "puzzled me" in some of its factual assumptions.[6] Indeed, the court observed that if the facts of the case as stated in the opinion were true, "there isn't any reason to have a trial."[7] Judge Pfaelzer expressed her suspicion that the Court of Appeals had done "more than just look at the indictment" in ruling, implying that the Ninth Circuit had made certain *factual* findings in its review of the dismissal of the indictment.[8] Indeed, she noted that the Court of Appeals' description of the transactions promoted by Petitioner contained a number of alleged facts not contained in the indictment, including some alleged facts the origin of which puzzled both the prosecutors and the defense.[9]

At trial, evidence was presented that Petitioner had been given advice by Margolis' law firm that the transactions, as well as the tax deductions claimed therefrom, were lawful, and that it was the Margolis law firm which actually was the architect and monitor of the transactions. Prior to 1979, Margolis had actually been acquitted of similar charges based upon his own role in virtually identical transactions (and was again acquitted in 1986). Uncontradicted evidence was presented that the Margolis firm viewed Margolis' acquittal as a vindication of "Margolis tax planning" using such circular financing. Evidence was presented that the transactions involving

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4 Trial transcript, p. 346. Similar doubts were also raised at pp. 177, 366.

5 *Id.*, p. 365.

6 *Id.*, p. 377.

7 *Id.*, p. 378.

8 *Id.*, p. 379.

9 *Id.*, pp. 381-385; 400.

Petitioner's partnerships were made with collected funds and that Petitioner's transactions were carried out in the same manner (and using the identical corporate lenders) as Margolis' transactions. Evidence was also presented that Petitioner had received opinion letters from the Margolis firm and subsequently [10] from the prominent tax firm of Hochman, Salkin & DeRoy which advised him that the transactions and deductions were lawful.

The government's own expert witness at trial admitted that until the mid-1980's, experts and courts (including the two judges who had acquitted Margolis and Judge Pfaelzer who had dismissed this prosecution) were divided over whether transactions such as those for which Petitioner was indicted were unlawful.

The District Court took the matter under submission. Two months later, on February 12, 1988, it ruled. The court announced that it had taken such a length of time

> because I had a great deal of difficulty with the problems in this case. The difficulty was greatly increased by some of the rather gratuitous statements in the 9th Circuit opinion. It is hard to know how much latitude was left to the District Court after the statements that were made in the 9th Circuit opinion. So having said that I say that I had some serious thinking to do about the evidence that was presented by the defense. I have given -- I have looked at the case several times. It has worried me ever since

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[10] In 1982, during the pendency of the alleged conspiracy pleaded in the indictment.

> I made the first decision. It worries me now. I am announcing that on the record. [11]

After expressing such doubts, the court announced its ruling: it found Petitioner not guilty on the perjury counts and guilty on the tax fraud counts. The court then admitted that "If I have had to look at this four times for all of the criminal cases that I have tried you must know that I have more serious thoughts about this case than usual." [12]

Petitioner filed a motion for acquittal. During argument on the motion, the Court reiterated the difficulty it was having in resolving the question of guilt or innocence:

> I think [this case] is the single most difficult set of facts from the standpoint of weighing the evidence I have seen in a long time.
>
> There is a lot of merit in what [defense counsel] said so I will look at it and it will stand submitted. [13]

Not until four months later did the Court rule on the motion for acquittal. Judge Pfaelzer denied the motion, but at the same time expressed her doubts:

> I have had a very difficult time with this case from the first moment that it came to me. The problem is created by attempting to decide what the intent of Mr. Schulman was in light of the fact that he was relying on the kind of advice that he was given.

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11 Transcript of February 12, 1988, p. 1.
12 *Id.*, p. 2.
13 Transcript of March 28, 1988 at 27.

> I went through the record intensively the first time when I made the decision that I made and I have done the same thing again and this is a very -- I am saying this for the record. This is a very tough judgment call the way it comes to the court because the court made the prior decision that it made having looked very carefully at the kind of plan that was put together. The evidence that came on in front of the court at the trial all went to the state of mind of Mr. Schulman.
>
> Now it is true that he didn't testify but he is not required to testify. The burden is on the government and in looking at the evidence, the evidence is very persuasive with respect to the legal advice, the soundness of the legal advice that was given, the reality of the transaction, and the burden being on the government to prove the case beyond a reasonable doubt. It is really a bit by bit analysis of the evidence and the inferences that can be drawn from it and I do not say that this period of time has not presented to me in three or four different ways some doubt about whether Mr. Schulman was guilty or not. I did that the first time. I did that the second time I looked at the evidence and the third time. However, I do believe that the government carried the burden beyond a reasonable doubt. [14]

Notwithstanding such doubts, the Court reaffirmed its earlier judgment of guilt. However, in sentencing Petitioner, the Court encouraged him to appeal, stating: "I

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14 Transcript of August 1, 1988, pp. 3-4.

think this is a case that should be looked at by the appellate court. It has been looked at by the appellate court once. It should be closely examined the second time."

The District Court once again expressed its doubts, in perhaps its strongest language yet, at a hearing on November 15, 1988. The Court stated:

> I think that I ought to say one thing on the record which is a statement from *[sic]* the 9th Circuit. I believe that the 9th Circuit opinion, the opinion which governed these proceedings, virtually dictated finding Mr. Schulman guilty, and I'm saying that for the benefit of the next panel and for the benefit of your argument.
>
> If you remember the 9th Circuit opinion characterizes the transaction. I am sure you remember those words from the opinion. Mr. Schulman is a lawyer, and whether he testified or not, the fact that he had the kind of background that he had and was a lawyer and the 9th Circuit characterized the transaction in the manner in which it did, virtually leads to the conclusion that he had to be found guilty.
>
> I want to tell you that if the 9th Circuit had not characterized the transaction that way, I believe that the court would have found him not guilty. [15]

Judge Pfaelzer's final comment reiterated her belief that her discretion as trier of fact had been restricted by the Court of Appeals:

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15 Transcript of November 15, 1988, pp. 9-10.

> ...if the 9th Circuit had left more area for the Court to deal with in terms of a fact finding, perhaps this would have gone differently. That is one of the difficulties about saying more than you intended to say in an opinion, or perhaps they intended to say that much.
>
> If they intended to say that much, they almost dictated the conclusion.[16]

Petitioner appealed to the Ninth Circuit. In its second review of this case, the court affirmed the conviction, but over a troubled dissent by Judge Reinhardt. The court concluded that there was sufficient evidence to support the conviction of Petitioner. It acknowledged that there were two possible interpretations of Judge Pfaelzer's ruling: (1) she convicted Petitioner solely on the basis of *Schulman I's* prior characterization of the transactions as shams, or (2) she implicitly agreed with the government that the transactions were shams due to the lack of economic substance to the transactions, and that Petitioner's conduct was willful. The Court of Appeals majority admitted that if the first interpretation of the District Court's ruling was accurate, a reversal would be required. But the Court of Appeals concluded that it had previously left open the question whether Petitioner's conduct had been willful; therefore, in convicting Petitioner the District Court must have discredited his defense that he had relied in good faith on the advice of counsel.

In finding the transactions to be "shams", the Court of Appeals concluded that the entities involved in the

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16 *Id.*, pp. 10-11.

transactions were not independent of one another [17] and implicitly found that collected funds were not used in the transactions, findings that did not appear to have been made by the District Court. The Court of Appeals also concluded that Petitioner's background as an accountant and lawyer was properly considered in deciding whether he was capable of forming the requisite intent to violate the law.

The Court dismissed Judge Pfaelzer's expressed doubts as to the correctness of her ruling as simply indicating her perception that this was a close case.

Judge Reinhardt, in dissent, was more troubled by Judge Pfaelzer's admissions of discomfort with her ruling. He observed that it was clear from the record that the district judge "did not feel free to exercise her fact-finding function fully." He opined that, understandably, Judge Pfaelzer had felt her authority had been drastically limited by the Court of Appeals' ruling in *Schulman I*. As a result, he concluded, Petitioner "may have been deprived of his right to have his guilt determined by a fact-finder who heard the evidence and observed the witnesses." He noted that Judge Pfaelzer may have incorrectly believed that the appellate court's first ruling had held that the indictment's allegations that Petitioner's transactions were illegal to be true. He concluded:

> the district court's decision to find appellant guilty may have been based on an overly broad reading of *Schulman I*. The appellant is entitled to have his guilt determined by a fact-finder who fully exercises

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[17] Contrary to the stipulation that neither Schulman, the partnerships nor any of the partners had any direct or indirect ownership interest in any of the entities.

> his or her authority. In a case such as this, where comments of the district judge suggest that she did not feel free to consider whether the actual evidence warranted particular legal consequences, i.e., a finding of not guilty, the appropriate remedy is to remand the case to the district court for reconsideration or clarification of its decision."

Accordingly, the dissent would have remanded the case with instructions to the District Court to reconsider the evidence and to clarify or vacate her ruling.

REASONS FOR GRANTING THE WRIT

This is truly a case which properly invokes this Court's supervisory powers and duties, pursuant to Rule 10.1(a), to correct the lower federal courts' departure from the accepted and usual course of judicial proceedings. It is a rare case where a federal district judge pronounces on the record, on several occasions, that her role as trier of fact in a criminal prosecution has been usurped by the court of appeals. It is a truly exceptional case where a federal court states for the record that but for such interference, the court most likely would have acquitted the defendant.

This case involves not only the allocation of factfinding duties between trial court and appellate court in a federal criminal case, but also the criminal defendant's rights to due process of the law and to the presumption of innocence. In this case, the district judge expressed her reasonable doubts as to Petitioner's guilt on the record, but nevertheless felt constrained to convict him.

Finally, this case presents the court with a conflict between at least two circuit courts of appeals with respect to the fair notice to which a taxpayer is entitled that his income tax-related conduct is illegal.

As the statement of the case reveals, there is no question but that the District Court felt that its fact-finding powers had been constricted by the Court of Appeals. Judge Pfaelzer repeatedly observed that the Ninth Circuit had apparently found certain facts which were not contained in the indictment and which were not apparent to her, and she candidly admitted that but for the *Schulman I*, she most likely would have acquitted Petitioner. She concluded that the Court of Appeals had "almost dictated the conclusion" and that if the Ninth Circuit had not characterized the transactions as it had, she "would have found him not guilty." [18]

I. The Court of Appeals Usurped the District Court's Role as Trier of Fact

It would seem to be beyond question that in reviewing the sufficiency of an indictment, a federal appellate court has no power to find facts or to dictate that the District Court find certain facts. In an analogous situation in a civil suit, the Fifth Circuit recognized that in reversing a grant of summary judgment to a defendant "our assessment of the facts was not a mandatory blueprint for all subsequent proceedings upon remand." *E.C. Ernst, Inc. v. General Motors Corp.*, 537 F.2d 105, 108 (5th Cir. 1976). In *Ernst*, the court made the unremarkable observation that the reversal of summary judgment does not foreclose the District Court's obligation to test the case

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[18] Transcript of November 15, 1988, pp. 10-11.

against the actual evidence adduced at trial, and even to direct a verdict for the defendant depending upon the actual proof made at trial.

In reversing the dismissal of the indictment herein, the Ninth Circuit had no power to find any facts or to direct the District Court to find any facts. All that the Court of Appeals could legitimately do was to determine that the indictment stated a triable offense. Indeed, in reviewing the sufficiency of an indictment, a Court of Appeals must necessarily accept the allegations of the indictment as true. *Boyce Motor Lines v. United States*, 342 U.S. 337, 343 n.16 (1952). The court's role is simply to determine whether the pleaded facts, *if true*, constitute a criminal act. The court has no right or power at such a stage to determine whether the defendant has in fact engaged in a criminal act, nor is it empowered to find that any of the elements of the crime are in fact present.

The District Court should have been free at trial to find that Petitioner's partnership transactions generated legitimate tax deductions, if the evidence adduced at trial supported such a finding. The District Court should have been free to conclude that Petitioner did not *willfully* violate the law. In fact, as Judge Pfaelzer recognized, there was ample evidence to support Petitioner's position at trial, but she felt constrained by the Ninth Circuit's mandate to conclude that the Government had carried its burden.

Although in *Schulman II* the Court of Appeals denied that its opinion in *Schulman I* had required the District Court to make any particular factual findings, a reading of *Schulman I* leads to the contrary conclusion. Certainly Judge Pfaelzer came to the contrary conclusion. In any event, what is important is that the trier of fact perceived that its discretion to find the facts as it saw them had been taken away. Under the circumstances, Petitioner was deprived of his right to a fair trial.

The district judge's conclusion that she had no choice but to accept the Ninth Circuit's view of the facts was apparently based upon the rule that "the mandate of an appeals court precludes the District Court on remand from reconsidering matters which were either expressly or implicitly disposed of upon appeal." *United States v. Miller*, 822 F.2d 828, 832 (9th Cir. 1987). Faced with an appellate ruling that virtually required her to convict Petitioner, Judge Pfaelzer could not exercise her usual function and obligation of trying and independently finding the facts.

Rather than dictate the outcome of the trial, the Ninth Circuit's ruling in *Schulman I* should have left total factfinding discretion to the District Court. Recognizing its limited role in *United States v. Melton*, 491 F.2d 45 (5th Cir. 1973), the Fifth Circuit correctly realized that it could not order the District Court to enter a judgment convicting the defendant of a crime when the jury had not already found all the elements of the crime, notwithstanding the fact that the Court of Appeals was satisfied that there was sufficient evidence from which a jury might be able to convict the defendant. The court properly recognized that it is for the finder of fact, in the first instance, to determine what the facts are, including the ultimate fact of innocence or guilt as well as all subsidiary facts. In contrast, the Ninth Circuit jumped the gun in this case and concluded, before trial, that certain facts establishing guilt existed. The District Court reluctantly concluded that it had no choice but to accept the Court of Appeals' version of the facts, which the Court felt dictated a finding of guilt.

Such a result violates our judicial system's fundamental notions as to the respective roles of the trial court (in cases tried without a jury) and the appellate court in finding the facts in a criminal trial. It is generally accepted that the trier of fact should be free to choose among all reasonable constructions of the evidence. *United States v. Gabriner*, 571 F.2d 49, 50 (1st Cir. 1978).

This rule is particularly important in criminal prosecutions, for as the Court noted in *United States v. Martin Linen Supply Co.*, 430 U.S. 564 (1977), the overriding responsibility of the trier of fact is to stand between the accused and a potentially arbitrary or abusive Government that is in command of the criminal sanction. *Id.* at 572. The Court was describing the role of the jury in particular, but the trial judge's duty to protect the accused is no less important when a jury has been waived.

In the case at bar, the District Court found itself in the position of a jury taking instructions from the Court of Appeals, which in turn assumed the role that a trial judge takes in a jury trial. In essence, Judge Pfaelzer felt that the Court of Appeals had directed her to return a verdict against Petitioner. But as the court observed in *Martin Linen Supply*, "a trial judge is prohibited from entering a judgment of conviction or directing the jury to come forward with such a verdict, regardless of how overwhelmingly the evidence may point in that direction. The trial judge is thereby barred from attempting to override or interfere with the jurors' independent judgment in a manner contrary to the interests of the accused." *Id.* at 572-73. *Accord: United Brotherhood of Carpenters v. United States*, 330 U.S. 395, 408 (1947); *Sparf v. United States*, 156 U.S. 51, 105 (1895). Clearly, a Court of Appeals is *a fortiori* barred from such interference with the role of the trier of fact.

It is unusual, and perhaps unprecedented, for a Court of Appeals to interfere in the trial court's factfinding function prior to the trial itself. More frequently, the issue of appellate interference in the factfinding process arises when the appellate court reviews the facts following a trial. In that context, the well-accepted rule is that in a criminal case, "after a guilty verdict by a jury or a finding of guilt by a trial court, an appellate tribunal may not substitute its inference from the evidence for those drawn by the

fact-finder, if there was sufficient evidence to submit to the factfinder in the first place." *United States v Cooper*, 567 F.2d 252, 253 (3d Cir. 1977). Appellate courts may not reverse trial court determinations of factual questions simply because they would have ruled differently. *Inwood Laboratories v. Ives Laboratories*, 456 U.S. 844, 857-58 (1982); *Maine v. Taylor*, 477 U.S. 131, 145 (1986), *citing Anderson v. Bessemer City*, 470 U.S. 564, 573 (1985); *Zenith Radio Corp. v. Hazeltine Research, Inc.*, 395 U.S. 100, 123 (1985).

Indeed, even when an appellate court does conclude that the trial court's findings of fact stepped beyond permissible bounds, "the usual rule is that there should be a remand for further proceedings to permit the court to make the missing findings." *Pullman-Standard v. Swint*, 456 U.S. 273, 291 (1982).

The foregoing rules are simply applications of the basic rule, repeatedly observed by the Court, that the factfinding function is "the basic responsibility of district courts, rather than appellate courts." *See, e.g., Maine v. Taylor*, 477 U.S. 131, 144-45 (1986); *Pullman-Standard v. Swint*, 456 U.S. 273, 291 (1982); *DeMarco v. United States*, 415 U.S. 449, 450, n. (1974).

Thus, as the Court noted in *Anderson v. Bessemer City*, 470 U.S. 564, 574 (1985), "the trial on the merits should be 'the "main event" ... rather than a "tryout on the road"'".

In the case at bar, the Court of Appeals did not even wait until after the tryout on the road. Rather, it pre-empted the trial court by making its own factual findings which the trial court believed it had no choice but to accept.

The Court of Appeals' usurpation of the District Court's factfinding function was especially inappropriate in light of the fact that a key issue which the District Court felt was taken out of its hands was whether Petitioner had *willfully* violated the income tax laws. As this Court has concluded, issues of intent and motive are peculiarly factual issues which should be left to the trier of fact. *See Pullman-Standard v. Swint*, 456 U.S. 273, 288 (1982); *United States v. Yellow Cab Co.*, 338 U.S. 338, 341 (1949).

The Court's words in *Pullman-Standard v. Swint*, 456 U.S. 273, 291-92 (1982), are equally applicable to the case at bar: "the Cour[t] of Appeals should not have resolved in the first instance this factual dispute which had not been considered by the District Court." Similarly, the Ninth Circuit should not have resolved factual issues which had not yet been considered by Judge Pfaelzer. When it did so, it prevented her from fulfilling her factfinding function.

Such a usurpation of the district court's function of trier of fact surely offends due process of law, for it violates our judicial system's "fundamental principles of liberty and justice." *McNabb v. United States*, 318 U.S. 332, 340 (1943). Moreover, even if such a bizarre procedure did not violate the Fifth Amendment, it nevertheless invokes this Court's duty of judicial supervision of the administration of criminal justice in the federal courts, which includes "the duty of establishing and maintaining civilized standards of procedure and evidence." *Id.*

II. Petitioner Was Convicted Despite the Trier of Fact's Expressed Reasonable Doubts

In reviewing the evidence of Petitioner's guilt in *Schulman II*, the Court of Appeals stated the general rule

that an appellate court is to consider whether any rational trier of fact could have found the essential elements of the crime beyond a reasonable doubt. *See* Appendix A at A-6.

This ignored the fact that Judge Pfaelzer, the trier of fact, repeatedly stated her own reasonable doubts on the record. Notwithstanding the fact that she ultimately stated her belief that the government had carried its burden beyond a reasonable doubt, she also analyzed the evidence on the record and expressed her substantial doubts in general and as to the proof of the elements of the charged crime. Thus, she stated that she had a great deal of difficulty with the case, and that it worried her even after looking at it several times. [19] She admitted that she had "more serious thoughts about this case than usual." [20] She stated that this was the "single most difficult set of facts from the standpoint of weighing the evidence I have seen in a long time," and that there was a lot of merit to the defendant's position. [21]

In particular, on the key and dispositive issue of intent, Judge Pfaelzer stated that "the evidence that came on in front of the court at the trail all went to the state of mind of Mr. Schulman" and that "the evidence is very persuasive as to the legal advice, the soundness of the legal advice that was given, the reality of the transaction, and the burden being on the government to prove the case beyond a reasonable doubt." She admitted that such evidence "presented to me in three or four different ways some doubt about whether Mr. Schulman was guilty or not." [22]

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19 Transcript of February 12, 1988, p. 1.

20 *Id.* at 2.

21 Transcript of March 28, 1988 at 27.

22 Transcript of August 1, 1988, pp. 3-4.

Thus, after expressing her view that there was "very persuasive" evidence that Petitioner engaged in the subject transactions after being given sound legal advice as to their legality, and that the transactions were "real", but apparently feeling that she had no other choice in light of the Ninth Circuit's mandate, the district court found that the Government had sustained its burden notwithstanding such eminently reasonable doubts.

Such a result offends the Due Process Clause of the Fifth Amendment, which requires "that the prosecution prove beyond a reasonable doubt every fact necessary to constitute the crime charged." *Mullaney v. Wilbur*, 421 U.S. 684, 685 (1975); *In re Winship*, 397 U.S. 358 (1970).

Petitioner was apparently found to have had the requisite intent because, according to the Ninth Circuit, the transactions were clearly illegal (although Judge Pfaelzer certainly did not find their illegality clear) and, as an accountant and lawyer, Petitioner was deemed to recognize their illegality. *But see United States v. Loney*, 719 F.2d 1435 (9th Cir. 1983) (rejecting contention that defendant must have known he was filing a false income tax claim because he was a "sophisticated lawyer, knowledgeable in business as well as professional matters" as "mere speculation."). But this Court has repeatedly held that even though intent is typically considered a fact peculiarly within the knowledge of the defendant, this does not justify shifting the burden of proof on that issue to him. *See Mullaney v. Wilbur*, 421 U.S. 684, 702 (1975); *Tot v. United States*, 319 U.S. 463, 469 (1943); *Leary v. United States*, 395 U.S. 6, 45 (1969). The courts below nevertheless shifted that burden on Petitioner. No evidence whatsoever was produced that Petitioner had any knowledge of the alleged illegality of the transactions; nor even any reason to believe they were illegal. Judge Pfaelzer apparently rested her finding of willfulness on the impermissible presumption that because of his credentials

as an accountant and a lawyer, Petitioner must necessarily have known that the transactions were unlawful, notwithstanding the fact that Judge Pfaelzer herself had believed the transactions to be lawful in her original ruling (Appendix D hereto), that two other judges had found the same transactions lawful in the prosecutions of Margolis, and that two reputable law firms had opined to Petitioner that the transactions were lawful.

It is submitted that when the trier of fact states its own reasonable doubts as to guilt on the record, it is impermissible for the Court of Appeals simply to ignore those doubts and independently review the record to satisfy itself that there is no reasonable doubt as to guilt.

As the Court stated in *Jackson v. Virginia*, 443 U.S. 307 (1979), "The *Winship* doctrine requires more than simply a trial ritual. A doctrine establishing so fundamental a substantive constitutional standard must also require that the factfinder will rationally apply that standard to the facts in evidence." But in the case at bar, the factfinder stated her rational reasons in favor of acquittal, but then convicted nevertheless in what could only be described as a trial ritual, containing the form but not the substance of a true adjudication of facts.

In *Jackson*, the Court observed that

> "a properly instructed jury may occasionally convict even when it can be said that no rational trier of fact could find guilt beyond a reasonable doubt, and the same may be said of a trial judge sitting as a jury. In a federal trial, such an occurrence has traditionally been deemed to require reversal of the conviction. *Glasser v. United States*, 315 U.S. 60, 80; *Bronston v. United States*, 409 U.S. 352, 93 S.Ct. 595. See

> also, *e.g., Curley v. United States,* 81 U.S.App.D.C. 389, 392-393, 160 F.2d 229, 232-233."

Such an occurrence took place here, and as Judge Reinhardt suggested in dissent, the proper outcome should be reversal of the conviction, remanding the case to the District Court with instructions to reconsider its judgment, to adjudicate the facts independently and to articulate the bases for its ruling.

III. The Decision in *Schulman I* Is in Conflict with Decisions of the Fourth Circuit

In 1983, The Ninth Circuit Court of Appeals reviewed and affirmed a simple but far-reaching principle of constitutional law as applied to prosecutions for willful violation of the Internal Revenue Code: the Due Process Clause of the Fifth Amendment requires that the law clearly proscribe the conduct charged at the time it was undertaken. *United States v. Dahlstrom,* 713 F.2d 1423 (9th Cir. 1983), cert. denied, 466 U.S. 980 (1984). If there is doubt about such fair notice, an indictment for tax fraud must be dismissed and the government must proceed civilly or administratively to establish clear guidelines to which taxpayers can *thereafter* conform their business practices. *Id.*

Dahlstrom was wholly consistent with preceding and subsequent decisions in the Fourth Circuit: *United States v. Mallas,* 762 F.2d 361, 363 (4th Cir. 1985) and *United States v. Critzer,* 498 F.2d 1160 (4th Cir. 1974). The decision of the Court below in *Schulman I,* however, reflects a wholesale turnabout by the Ninth Circuit. The holding in *Dahlstrom* is limited in the *Schulman I* to the point of extinction. A plain reading of *Schulman I* presents

a clear conflict with the controlling law in the Fourth Circuit under *Mallas* and *Critzer*.

A. *Dahlstrom* and its Progeny

In *United States v. Dahlstrom*, 713 F.2d 1423 (9th Cir. 1983), *cert. denied*, 466 U.S. 980 (1984), the government sought to hold investment counsellors criminally liable for promoting and participating in a tax shelter program by which deductions were created for the transfer of monies to foreign trusts which then gifted the funds back to the taxpayer in a tax-free transfer. The *Dahlstrom* defendants promoted and helped taxpayers set up a scheme involving three foreign trusts, all under the control of the taxpayer. The taxpayer then purchased a tax-deductible "tax counselling program" from Trust 2, a non-resident alien. To reduce the potential U.S. tax liability of Trust 2, Trust 1 (which was trustee of Trust 2 and Trust 3) caused Trust 2 to make payments to Trust 3, the income of which was not taxable (a foreign entity receiving foreign income). Trust 3 would then lend the funds back to Trust 2 in exchange for a demand note. Trust 3 thereafter gifted the note to the taxpayer as a tax-free gift. The taxpayer finally presented the note to Trust 2 and received his money back tax-free as "gift" income. Some of the defendants assisted in establishing the foreign trusts by traveling abroad and executing trust documents on behalf of the taxpayers. 713 F.2d at 1425-26.

It is abundantly clear that there was no economic reality to the transaction in *Dahlstrom*. the plan was an elaborate artifice to create a tax deduction. At the end of the day, the taxpayer ended up with both his deduction and his money and no real change in his position. In sharp contrast, here each of the Partnerships established by Petitioner was capitalized with real cash from outside investors; real funds were transferred to pay an enforceable

interest obligation of the partnership; and each of the partnerships had acquired a real and substantial asset: a building under long-term lease, the acquisition cost of which was financed under extremely favorable terms.

Dahlstrom held, nevertheless, that since no statute, regulation or court decision in existence at the time of the allegedly fraudulent act indicated that the use of foreign trusts there would result in criminal prosecution, a prosecution under §7206(2) could not lie. The element of willfulness--an essential element of the offense--was found to be necessarily lacking without regard to the defendant's subjective intent:

> We are convinced that the legality of the tax shelter program advocated by the appellants in this case was completely unsettled by any *clearly relevant precedent on the dates* alleged in the indictment.

Id. at 1428 (emphasis supplied).

The *Dahlstrom* holding was subsequently reaffirmed in *United States v. Little*, 753 F.2d 1420, 1433 (9th Cir. 1984), where the court recognized that *Dahlstrom* required that a person be given fair notice as to what constitutes illegal conduct so that he may conform his conduct to the requirement of the law, and observed that in *Dahlstrom*, there was no statute or case law that expressly made illegal the type of tax shelters promoted by the defendants. Thus, the defendants could not have had fair notice that their conduct was illegal. the court noted that where a defendant is not given fair notice of the requirements of the law, he necessarily lacks the requisite intent to violate the law.

B. The Fourth Circuit Decisions in *Mallas* and *Critzer*

In *United States v. Mallas*, 762 F.2d 361 (4th Cir. 1985), as in *Dahlstrom*, the Government sought to hold the defendants criminally liable for promoting a tax shelter program based on deductions taken for investments drafted to take advantage of the tax law based on royalty payments for coal-mining ventures. The Government charged that the subject investment program was an illegal scheme to evade taxes.

The Government's case in *Mallas* was based on an interpretation of a regulation that did not directly address deductibility of royalty payments in such circumstances and which had never been administratively interpreted in other regulations, courts, or administrative rulings. *Id.* at 364. The Fourth Circuit reversed the defendants' convictions, holding that the imposition of criminal punishment based on the Government's debatable interpretation of the relevant Treasury Regulation violated due process. "Criminal prosecution for the violation of an unclear duty itself violates the clear constitutional duty of the government to warn citizens whether particular conduct is legal or illegal." *Id.* at 363.

Significantly, the Fourth Circuit did not reject the Government's interpretation of the Treasury Regulation. It only held that the "vague or highly debatable" nature of the issue precluded criminal punishment. *Id.* at 363-65. The Court stressed that the Government's "pioneering interpretation" could not be adopted for the first time in a criminal prosecution, *id.* at 365, quoting *United States v. Critzer*, 498 F.2d 1160, 1164 (4th Cir. 1974). *Dahlstrom* had held the same.

C. The Abandonment of *Dahlstrom*

In *Schulman I*, however, the Ninth Circuit effectively abandoned the fair notice requirements previously embraced in *Dahlstrom*. First, the Court stated that *Dahlstrom* applied only to "pure advocacy" cases and does *not* stand "for the proposition that when the legality of a tax shelter is unsettled by clearly relevant precedent an indictment must be dismissed because the requisite intent is lacking." Second, the court held that due process and fair notice may be satisfied whenever the Government invokes the maxim that "sham transactions are illegal." *Knetsch v. United States*, 364 U.S. 361 (1960). But the Court never addressed the legality of the mechanics of the specific transaction at issue here, or the uncertain state of the tax law regarding those mechanics. Hence, the court below begged the question of whether clear precedent proscribed the participants' particular tax plan. *Dahlstrom's* "clear precedent" requirement has been effectively written out of the Ninth Circuit law.

This holding is in direct conflict with *Mallas* and *Critzer*. *See also Nordstrom v. United States*, 360 F.2d 734, 735 (8th Cir.), *cert. denied*, 385 U.S. 826 (1966) (in order to be criminally liable for tax evasion, "it first must appear that [one] was under a civil liability to pay the tax. In addition, his civil liability must have been so clearly the law at the time the erroneous return was filed that [his actions] amounted to a willful evasion."); *United States v. Heller*, 866 F.2d 1336, 1342-43 (11th Cir. 1989) (one way to demonstrate lack of intent is to point to a Tax Court decision, IRS opinion or some other authoritative statement that arguably condones activities similar to defendant's for similar ends. If defendants patterned their transaction after such a statement, or in good faith intended to do so, they cannot be criminally liable.); *United States v. Heller*, 830 F.2d 150, 154-55 (11th Cir. 1987) (intent cannot be proved

when the law was uncertain or cast in doubt by prior court decisions; intent is a question of fact).

Obviously, given the unsuccessful prosecutions of Margolis, Petitioner's lawyer and the architect of Petitioner's transactions, and given the opinions he had received as to the propriety of the transactions, Petitioner could not be convicted under the *Mallas-Dahlstrom* line of cases. Indeed, the Court of Appeals should have affirmed the dismissal of his indictment.

Review by the Supreme Court is warranted to remedy the conflicts noted above.

CONCLUSION

For the reasons stated, certiorari should be granted and the judgments of the Court of Appeals vacated. The case should be dismissed, as the District Court had originally ruled, or at the very least sent back to the District Court with instructions to try the facts independently.

Respectfully submitted,

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APPENDIX A

APPENDIX A

NOT FOR PUBLICATION
UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

No. 88-5278
D.C. No. CR-86-00253-MRP

UNITED STATES OF AMERICA,
Plaintiff-Appellee,

vs.

GERALD L. SCHULMAN,
Defendant-Appellant.

No. 88-5278
D.C. No. CR-86-00253-MRP

MEMORANDUM*

Filed Nov. 15, 1989

Appeal from the United States District Court
for the Central District of California
Mariana R. Pfaelzer, District Judge, Presiding

Submitted May 4, 1989**
Pasadena, California

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* This disposition is not appropriate for publication and may not be cited to or by the courts of this circuit except as provided by Circuit Rule 36-3.

** The panel unanimously finds this case suitable for decision without oral argument. Fed. R. App. P. 34(a); Circuit Rule 34-4.

BEFORE: SNEED, REINHARDT, and BRUNETTI, Circuit Judges

Gerald Schulman appeals from a conviction of conspiracy and tax fraud in violation of 18 U.S.C. §371 and 26 U.S.C. §7206(1) and (2). The conduct underlying the convictions is not disputed; the only issue being appealed from is whether there is sufficient evidence to support a finding that the appellant willfully violated the tax code. We affirm.

FACTS AND PROCEEDINGS BELOW

Between 1978 and 1979 the appellant organized and promoted eighty-seven limited partnership tax shelters in which he was the general partner. Each partnership used short-term circular financing to generate interest expenses in order to secure long-term low rate financing. The long-term financing was used to acquire postal and public utility properties for lease to the government.

While the ostensible purpose of the partnerships was to acquire postal and other public buildings for lease to the government, investors were offered the prospect of a one-hundred percent first year write-off of their contributions to the partnerships. Schulman orchestrated a series of paper transactions involving two foreign corporations and a foreign bank to realize this objective. A Schulman partnership would "borrow" approximately $3 million on a 10 percent promissory note from Hexagram, N.V., a Netherlands Antilles financing company. Hexagram obtained the money from a Panamanian bank, Iberoamerica, giving its own promissory note at 9.75 percent interest. The Schulman partnership would deposit the $3 million, interest free,

with a Panamanian company, Parallax Corp., in return for Parallax's guarantee to provide the partnership with favorable, i.e. nothing down, 4-5% fixed rate, 35-40 year financing with which to acquire postal properties. Parallax would then deposit the money in its account with Iberoamerica and instruct it to purchase the note from Hexagram. Thus, the circle was completed without any money actually changing hands.

By so completing the circle a Schulman partnership would show on its balance sheet a debit of $3 million representing the Parallax deposit and a credit of $3 million representing liability on its note payable at 10 percent to Hexagram. On the balance sheet of Hexagram the partnership note would be a debit and there would be a credit of $3 million representing its note to Iberoamerica. Parallax on its balance sheet would have a $3 million credit representing the deposit by a Schulman partnership and a $3 million debit representing its deposit in Iberoamerica. The Iberoamerica balance sheet would show the $3 million deposit by Parallax as a credit and a debit of $3 million would represent the Hexagram note. No entity experienced a change in its net worth and no money actually changed hands. While the transaction generated promissory notes that called for payments, the question is whether these were "interest" payments.

This transaction was executed thirty-three times on October 31, 1978, and fifty-six times on December 5, 1978, each time with a different Schulman partnership, generating a debt of $252 million to the partnerships on the notes payable to Hexagram. Approximately one year later through a series of similar but not identical transactions the debt of all the partnerships was removed from their books and the partnerships claimed interest

deductions of $25.2 million, which, after business expenses, coincided with the capital contributions of the Schulman investors. It is not disputed that Parallax actually provided the partnerships with low rate financing for the acquisition of public properties.

Presumably each participant in the scheme was to profit from the transactions, a profit that could come from the capital contributions of the Schulman partners who received very favorable long-term financing and sought to obtain a full deduction for their $28 million investment.

The government did not agree with the interest deduction by the partnerships. On March 20, 1986 Schulman was charged in a twenty-five count indictment with conspiracy to defraud the United States in violation of 18 U.S.C. §371, assisting in the preparation of fraudulent tax returns in violation of 26 U.S.C. §7206(2), filing a fraudulent tax return in violation of 18 U.S.C. §7206(1), and making false declarations in violation of 18 U.S.C. §1623.

Schulman moved to dismiss the conspiracy and tax fraud violations on the ground that the government would be unable to establish that the tax shelters were clearly unlawful in 1978 and 1979, thus negating the willful element of the charges. The district court agreed and dismissed these charges along with the false declaration counts, finding that the appellant "could not have had fair notice that his conduct was illegal." This court reversed the dismissal of the conspiracy and tax fraud counts, characterizing the transactions as "a sham that lacked substance because there was no economic risk associated with the purported loans." *United States v. Schulman ("Schulman I")*, 817 F.2d 1355, 1361 (9th Cir. 1987).

After characterizing the transaction as a sham, the court stated that "[t]he only question is whether there were real interest payments on genuine indebtedness. The indictment sufficiently alleges a lack of substance behind the check cycle to sustain a motion to dismiss." *Id.* at 1359. The court further stated that, "assuming the truth of the allegations in the indictment, the defendant was engaged in promoting a tax scheme, the illegality of which he had fair notice." *Id.* at 1361.

On remand the district court found Schulman guilty of the conspiracy and tax fraud charges, expressing "serious thoughts" about the case, and stating that its difficulty had been "greatly increased by some of the rather gratuitous statements in the 9th Circuit opinion." At sentencing the judge reiterated these sentiments, noting that "this is a case that should be looked at by the appellate court." At a later hearing when a plan of community service for the appellant was presented, the judge continued:

> I think that I ought to say one thing on the record which is a statement [for] the 9th Circuit. I believe that the 9th Circuit opinion, the opinion which governed these proceedings, virtually dictated finding Mr. Schulman guilty, and I am saying that for the benefit of the next panel and for the benefit of argument.
>
> If you remember the 9th Circuit opinion characterizes the transaction [as a sham]. I am sure you remember those words from the opinion. Mr. Schulman is a lawyer, and whether he testified or not, the fact that he had the kind of background that he had and was a

> lawyer and the 9th Circuit characterized the transaction in the manner that it did, virtually leads to the conclusion that he had to be found guilty.
>
> I want to tell you that if the 9th Circuit had not characterized the transaction that way, I believe that the court would have found him not guilty.
>
> ...
>
> [I]f the 9th Circuit had left more area for the court to deal with in terms of a fact finding, perhaps this would have gone differently. That is one of the difficulties about saying more than you intended to say in an opinion, or perhaps they intended to say that much.
>
> ...
>
> If they intended to say that much, they almost dictated the conclusion.

Schulman appeals.

STANDARD OF REVIEW

In reviewing the sufficiency of the evidence we consider whether "after viewing the evidence in the light most favorable to the prosecution, any rational trier of fact could have found the essential elements of the crime beyond a reasonable doubt." *United States v. Marchini*, 797 F.2d 759, 755 (9th Cir. 1986), *cert. denied*, 479 U.S. 1085 (1987). While circumstantial evidence and

inferences drawn therefrom may be sufficient to sustain a conviction, *United States v. Talbert*, 710 F.2d 528, 530 (9th Cir. 1983), *cert. denied*, 464 U.S. 1052 (1984), speculation is not. *United States v. Lewis*, 787 F.2d 1318, 1323 (9th Cir. 1986).

DISCUSSION

The appellant argues that his good faith reliance on the advice of counsel should defeat a finding that he specifically intended to violate the law, and that his background as a lawyer and accountant was improperly used to infer willfulness.

The trial judge made no express findings of fact. Thus, it can be concluded that she either convicted the appellant solely on the basis of *Schulman I*'s characterization of the transaction as a sham, in which case reversal would be required, or that she implicitly agreed with the government that the scheme was indeed a sham because there was no economic substance to the transactions, and that Schulman's conduct was willful. The *Schulman I* court expressly left open the question of whether Schulman's conduct was willful, and the fact that the district judge convicted Schulman leads us to the conclusion that she discredited his good faith reliance on the advice of counsel defense.

The appellant asserts that he could not have willfully violated the law because he relied in good faith on the opinion letters of law firms that indicated that the transactions in question were legal, and that his level of sophistication as a lawyer and accountant was used against him to support an interference that his conduct was willful. We are not persuaded.

The letters relied on by the appellant assume that the entities involved would be independent of one another. That was not the case here. If Schulman were to be believed that each entity in the transactions acted independently and at arm's length from the others, then each would have made substantial unsecured loans to another. This is not credible. The only reason the transactions were executed is that each entity knew of the circularity of the scheme, and each knew that there was no risk involved. Moreover, one of the opinion letters was written in 1982, several years after the transactions were executed. This letter clearly could not have been relied on.

Schulman claims to have relied on the validity of the "Margolis" tax plan, a similar scheme, in formulating the Schulman partnerships. Even assuming the validity of the Margolis plan there is nothing to indicate that the Schulman plan was the same scheme, particularly on the question of whether collected funds were used to fuel the loans. The record indicates that less than $2000 was initially deposited by the partnerships, and this was the only cash that was available to any of the parties during the life of the loans. The $252 million was the result of a wash transaction that was cycled until it reached the desired aggregate amount. Schulman's reliance argument is not relevant because there is insufficient evidence to establish that the Schulman scheme was the same as the one that was allegedly legal.

Regarding Schulman's "sophistication" argument, the facts that Schulman was a lawyer and accountant, coupled with his level of involvement, can be more easily construed against him than in his favor. The government is correct that the appellant's background was properly considered in deciding whether he was capable of forming

the requisite intent to violate the law. He was not duped into this scheme because of his ignorance of finance and the law; he used his knowledge of financial arrangements with offshore organizations to orchestrate this scheme in an attempt to circumvent the tax laws. The appellant's background was only one of several factors that were used to consider the issue of willfulness.

CONCLUSION

The evidence is sufficient to support a finding that Schulman willfully engaged in the conduct that led to his conviction. Although the district judge failed to make findings of fact, she nonetheless considered all the evidence and found the appellant's conduct willful in convicting him. The statements made by the trial judge indicate that this was a close case, and that circumstantial evidence could have supported an acquittal. These statements, however, do not establish that the judge failed to make independent findings of fact, or that she did not conclude that the appellant was guilty beyond a reasonable doubt. The appellant's convictions are affirmed.

AFFIRMED.

United States v. Schulman
No. 88-5278
Reinhardt, Circuit Judge, dissenting:

It is clear from the record that in convicting the defendant of willful violations of the tax laws the district judge did not feel free to exercise her fact-finding function fully. Her reason is understandable. She believed that her authority was drastically limited by *United States v.*

Schulman, 817 F.2d 1355 (9th Cir. 1987), (*Schulman I*). While the district court's reading of *Schulman I* is a plausible one, it appears to be overly broad. As a result, the appellant may have been deprived of his right to have his guilt determined by a fact-finder who heard the evidence and observed the witnesses. I therefore dissent from the affirmance of the conviction and would remand the case with instructions to the district judge to reconsider the evidence and clarify or vacate her ruling.

In *Schulman I*, we reversed the district court's dismissal of the tax fraud and conspiracy charges lodged against the appellant. Our dismissal was based on the district court's conclusion "that the government could not prove the element of willfulness . . . because the government could not show that the type of tax shelter promoted by Schulman was clearly illegal . . . ." 817 F.2d, at 1356-57. We reached the contrary conclusion, holding that the type of transactions alleged by the government were clearly illegal at the time appellant allegedly engaged in them and, thus, that "dismissal of the indictment was improper since an intent to violate the law cannot be ruled out as a matter of law." *Id.* at 1360.[1]

The decision in *Schulman I* went only to the sufficiency of the allegations contained in the indictment. Notwithstanding the breadth of some of our statements, our language must be read in that context. We did not, as the district judge may have believed, hold the government's allegations that the appellant's transactions were illegal to be true. That question was left for the

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[1] A different panel of our court decided *Schulman I*. That fact, however, is of no legal consequence.

district judge to decide, as was the question whether the appellant had the requisite intent to violate the tax laws. The court merely held that assuming the facts to be as the government alleged, the transactions as described were clearly illegal and that, therefore, the indictment sufficiency alleged a violation of the tax laws.

Despite this limited holding of *Schulman I*, the district judge appears to have read it somewhat more broadly. At trial, during the sentencing hearing, and again at a later hearing concerning a program of community service for the defendant, the judge repeatedly commented on what she felt to be constraints on her fact-finding functions imposed by our earlier decision. Specifically, she indicated that the characterization of the appellant's transactions as "sham" dictated a guilty verdict. She stated:

> I believe that the 9th Circuit opinion, the opinion which governed these proceedings, virtually dictated finding Mr. Schulman guilty . . . .
>
> If you remember the 9th Circuit opinion characterizes the transaction. I am sure you remember those words from the opinion. Mr. Schulman is a lawyer, and whether he testified or not, the fact that he had the kind of background that he had and was a lawyer and the 9th Circuit characterized the transaction in the manner in which it did, virtually leads to the conclusion that he had to be found guilty.
>
> I want to tell you that if the 9th Circuit had not characterized the transaction that way,

> I believe that the court would have found him not guilty.[2]

But *Schulman I*'s characterization of the transactions as sham was a characterization limited to the *facts as alleged in the indictment.* The court assumed the facts to be true for purposes of passing on the sufficiency of the indictment. The facts developed at trial may have varied to some extent from those set forth in the indictment or, possibly, additional facts may have been adduced that would justify a different conclusion. In short, the district court was responsible for determining whether in light of all the facts and circumstances introduced into evidence the *actual* transactions met the definition of "sham." Indeed, the district judge must have sensed that *Schulman I* left her a certain amount of discretion since she heard evidence on the nature of the appellant's transactions and the economic risks involved; issues that would have been foreclosed by *Schulman I* had its effect been as restrictive as is suggested in her comments.

That is not to say that the district judge's sense of constraint was in any way unreasonable. For example, were she to conclude that the transactions engaged in by the appellant were of the type identified in *Schulman I* as "sham" the only remaining question would be that of appellant's intent. And that question, as the district court

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[2] She also made statements such as, "It is hard to know how much latitude was left to the District Court after the statements that were made in the 9th Circuit opinion." and "[B]ut if the 9th Circuit had left more area for the court to deal with in terms of a fact finding, perhaps this would have gone differently. That is one of the difficulties about saying more than you intended to say in an opinion. . . If they intended to say that much, they almost dictated the conclusion."

indicated, may largely be answered by the clear illegality of the transactions combined with the appellant's background and expertise as a lawyer. Nevertheless, while there may not ultimately have been much for the district judge to decide, if such was the case it was because of the clarity of the law once the facts were established, not because *Schulman I* had determined the facts.

Unfortunately, I do not believe that we can determine from the district judge's opinion the precise basis for her decision. She heard evidence that the appellant's transactions differed from those alleged in the indictment and commented on its persuasiveness. Still, she found the appellant guilty of the crimes alleged. Whether this was because she found the evidence established that the actual transactions met the "sham" test discussed in *Schulman I* or because she read *Schulman I* to require that outcome regardless of any possible differences in the facts is unclear.

What is clear, however, is that the district court's decision to find appellant guilty may have been based on an overly broad reading of *Schulman I*. The appellant is entitled to have his guilt determined by a fact-finder who fully exercises his or her authority. In a case such as this, where comments of the district judge suggest that she did not feel free to consider whether the actual evidence warranted particular legal consequences, i.e., a finding of not guilty, the appropriate remedy is to remand the case to the district court for reconsideration or clarification of its decision. Accordingly, I would remand this case with instructions to the district judge to reconsider the verdict and either to vacate it or reaffirm it with a fuller explanation of the court's reasons.

APPENDIX B

APPENDIX B

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

No. 88-5278
D.C. No. CR-86-00253-MRP

UNITED STATES OF AMERICA,

Plaintiff-Appellee,

vs.

GERALD L. SCHULMAN,

Defendant-Appellant.

Filed Feb. 14, 1990

ORDER

BEFORE: SNEED, REINHARDT, and BRUNETTI, Circuit Judges.

The panel has voted to amend the memorandum disposition filed November 15, 1989 as follows:

Heading, page 1, insert "Argued and" before "Submitted," and delete the footnote, "The panel unanimously finds this case suitable for decision without oral argument. Fed. R. App. P. 34(a); Circuit Rule 34-4."

With the memorandum thus amended, Judge Sneed and Judge Brunetti have voted to deny the petition for rehearing. Judge Reinhardt has voted to grant the petition for rehearing. The panel has unanimously voted to reject the suggestion for rehearing en banc. The full court has been advised of the suggestion for rehearing en banc and no active judge has requested a vote on whether to rehear the matter en banc. Fed. R. App. P. 35(b).

The petition for rehearing is DENIED and the suggestion for rehearing en banc is REJECTED.

APPENDIX C

APPENDIX C

United States District Court for
Central District of California

Docketing CR 86-253-A-MRP

UNITED STATES OF AMERICA,

v.

DEFENDANT GERALD L. SCHULMAN,

JUDGMENT AND PROBATION
COMMITMENT ORDER

In the presence of the attorney for the government the defendant appeared in person on this date----------» 11 15 1988

WITH COUNSEL Raymond W. Bergan and Mark J. Hulkower (Retained)[Filed July 31, 1986]

PLEA NOT GUILTY

FINDING & JUDGMENT

There being a finding of GUILTY to counts 1-20.

Defendant has been convicted as charged of the offense(s) of conspiracy; aiding in preparation and presentation of false documents; making and subscribing a false tax return in violation of 18 USC 371; 26 USC 7206(2); and 7206(1) as charged in the indictment.

SENTENCE OR PROBATION ORDER

IT IS ADJUDGED that the imposition of sentence is hereby suspended and the defendant is placed on probation for a period of five (5) years as to counts one through twenty on the following terms and conditions; (1) that the defendant comply with all rules and regulations of the Probation Office and General Order No. 225; (2) that the defendant comply with all rules and regulations of the Internal Revenue Service and pay all taxes including interest and penalties in an amount and manner as determined by the IRS; (3) that the defendant pay the cost of prosecution in the amount of $22,500.00; and (4) that the defendant contribute 1000 hours of community service specifically for the benefit of the poor, elderly, and disadvantaged; the Probation Officer is to approve and supervise such service and submit a report to the Court at least yearly regarding its rendition.

IT IS ORDERED that the defendant, whose address is 15921 Royal Oak Road, Encino, Ca. 91436 pay a mandatory $50.00 special assessment fee as to count one, pursuant to 18 USC 3013(a), payable to the U.S. Treasury, U.S. Attorney, 312 North Spring St., Los Angeles, Ca. 90012, Room 1347. (Claims and Judgments).

IT IS FURTHER ORDERED that on motion of the U.S. Attorney case CR 86-253-MRP is dismissed and the defendant's bond is exonerated.

IT IS FURTHER ORDERED that said counts one through twenty shall run concurrently with each other.

FILED: 11-23-88
Leonard Brosnan, Clerk

By

Robert J. Flores, Deputy Clerk

/s/ Mariana R. Pfaelzer
November 23, 1988

APPENDIX D

APPENDIX D

UNITED STATES DISTRICT COURT
CENTRAL DISTRICT OF CALIFORNIA

Case No. CR 86-253 MRP

UNITED STATES OF AMERICA,

Plaintiff,

v.

GERALD L. SCHULMAN,

Defendant.

[Filed July 31, 1986]

MEMORANDUM AND ORDER DISMISSING COUNTS 1-20, 22, 23, AND 25 OF FIRST SUPERSEDING INDICTMENT

Defendant's motions to dismiss the first superseding indictment and for a bill of particulars came on for hearing before the Honorable Mariana R. Pfaelzer on June 9, 1986. The Court, having considered the papers filed and the oral arguments made, grants defendant's motion to dismiss with respect to counts 1-20, 22, 23 and 25.

I.

COUNTS 1-20

A. Background

The central issue in this case is the proper characterization of certain payments made by 91 real estate limited partnerships (hereinafter "the 1979 partnerships") in connection with the purchase of buildings leased to the United States Postal Service, public utilities and various state governmental units. The payments resulted in a 1:1 tax deduction, *i.e.*, a deduction equal to the total capital contribution made by each limited partner.

The facts in the case do not appear to be in dispute. In 1978, defendant Gerald L. Schulman ("Schulman") organized and promoted the 1979 limited partnerships ("the partnerships") which were formed for the purpose of acquiring various post office and public utility buildings. In promoting the sale of the partnership interests, Schulman represented to potential investors that the money invested in the 1979 partnerships would be deductible on their 1979 tax returns as an interest expense (Indictment ¶17A).

The tax objectives contemplated by the partnerships were accomplished by a series of financing and loan transactions between the partnerships and two offshore corporations, Hexagram, a Netherlands Antilles corporation, and Parallax, a Panamanian corporation. Each of the partnerships secured a short-term loan from Hexagram and executed a promissory note in Hexagram's favor. The partnership then delivered the funds loaned

from Hexagram to Parallax pursuant to a financing agreement. Under the terms of the financing agreement, Parallax agreed to obtain favorable long term financing to enable the partnership to purchase a post office or public utility building on a no down payment basis. In exchange, the partnership agreed to charge Parallax no interest on the sums deposited with Parallax. Finally, the financing agreement provided that after a period of one year or less, Parallax would return the sum deposited to the partnership. Upon the return of the money deposited, the partnership repaid the loan to Hexagram with interest. The interest payment equalled the initial capital contribution of the partners.

Pursuant to these arrangements, each of the partnerships took a first year deduction based on the short-term loans from Hexagram. The government concedes that these contested interest payments were made with initial capital contributions from the limited partners (*i.e.*, the payments were made with "real" money). Moreover, the government acknowledges that the partnerships purchased, and own today, real buildings located in the United States; that the buildings produce substantial real income for the partnerships; and that these transactions have economic substance independent of any tax consequences. Transcript of argument on June 9, 1986 (hereinafter "Tr.") AT 35, 37, 41.

Furthermore, the government does not contest that Hexagram and Parallax were companies duly organized under the laws of the Netherlands Antilles and Panama, respectively. There is no allegation by the government that Schulman owned stock in either Hexagram or Parallax. Nor does the government allege that any of the partnerships, general partners, or limited partners had any

ownership interest in Hexagram or Parallax. Finally, the government does not contend that the promissory notes executed by the partnerships in favor of Hexagram were either invalid or unenforceable.

What the government alleges is that the loan and financing transactions between the partnerships and Hexagram and Parallax had no economic substance. Therefore, the government charges that the cash payments made by the partnerships cannot be characterized as interest payments.

The indictment charges that $252,000,000 in checks was drawn from an account in the name of Hexagram at a Panamanian bank, Banco de Iberoamerica; that the checks were deposited into accounts of the 1979 partnerships; that Schulman, who was the general partner in each of the 1979 partnerships, drew $252,000,000 in checks from these accounts which was then deposited to the account in the name of Parallax; and that finally the Parallax account was debited in like amount, with a corresponding transfer to the account of Hexagram. Indictment, ¶17E. Banco de Iberoamerica was a Panamanian bank operating in Panama in which checking accounts were maintained in the names of Hexagram, Parallax and the 1979 partnerships. Indictment ¶11. It is undisputed that the transfers from Hexagram to the partnerships to Parallax to Hexagram all took place on the same day at Banco de Iberoamerica.

The government alleges that there never was $252,000,000 in cash to be loaned and that the transactions which took place were mere "check swaps" which could not be reasonably characterized as loans.

II.

DISCUSSION

Defendant's Motion to Dismiss raises essentially a legal question of whether due process requires dismissal of the tax counts of the indictment. The Court finds that a trial on the facts surrounding the commission of the alleged offenses would not aid the Court in determining the validity of this due process defense. Under these circumstances, the Court has discretion to rule on the defense pursuant to a motion to dismiss. *See, e.g., United States v. Covington, 395* U.S. 57 (1969); *United States v. Jones*, 542 F.2d 661 (6th Cir. 1976); *United States v. Korn*, 557 F.2d 1089 (5th Cir. 1977).

In ruling on a motion to dismiss, the Court may consider the factually allegations made in the indictment and facts proffered by the government in a bill of particulars. *United States v. Jones, supra*. Although it is unnecessary here, the Court may also consider uncontested factual allegations made by the defendant which do not contradict the essential allegations in the indictment. *United States v. Jones, supra*. It necessarily follows that the Court may dismiss the tax counts of the indictment where, as here, facts alleged in the indictment, statements by the government in its Memorandum of Law accompanying affidavits, and representatives made by the government in oral argument, even if proven at trial, are insufficient to crate a triable issue of fact with regard to defendant's due process defense.

In order to convict a person under 18 U.S.C. §7602 (1) for making or subscribing a false tax return and under 18 U.S.C. §7602(2) for aiding in the preparation and

presentation of a false tax return, the government must prove beyond a reasonable doubt that the acts of the defendant were willful. *United States v. Crum*, 529 F.2d 1380 (9th Cir. 1976); *United States v. Dahlstrom*, 713 F.2d 1423, 1426-7 (9th Cir. 1984). The Supreme Court has defined the term "willfully" under Section 7206 to mean a "voluntary intentional violation of a known legal duty," which "requires more than a showing of careless disregard for the truth." *United States v. Pompanio*, 429 U.S. 10, 12 (1976). In order to prove this element of willfulness, the government must establish that the type of tax shelter promoted by Schulman was clearly illegal in 1978 and 1979.

In this case, the government attempts to apply the so-called "step transaction" doctrine to characterize the cash payment made by the partnerships to the foreign lender as something other than interest. To the extent the government relies here on the concept of "form over substance," it is attempting to base a criminal prosecution on the type of legal precedent that the Ninth Circuit has held--in the context of establishing the requisite criminal intent for purposes of tax fraud--to be insufficient. *United States v. Dahlstrom*, 713 F.2d 1423, 1427 (9th Cir. 1983), *cert. denied*, 466 U.S. 980 (1984).

As stated by the Ninth Circuit, "Due process requires that a person be given fair notice as to what constitutes illegal conduct so that he may conform his conduct to the requirement of the law." *Dahlstrom, supra*, at 1427. During the period from 1978 and 1979, the time period at issue in the indictment, there was no statute that made illegal the type of tax plan promoted by Schulman, nor was there any case law or regulation from which it could have fairly been concluded that the tax plan promote by

Schulman was illegal. Indeed, in 1975, the government prosecuted Harry Margolis, the attorney who assisted Schulman in setting up the instant partnerships, for tax fraud on the same theory of sham circle transfers at issue in this case. *United States v. Harry Margolis, et al.*, CR 75-849 WAI. Judge Ingram dismissed several counts and the jury acquitted Margolis on the remaining counts. Therefore, Schulman had reason to believe his activities were permissible and could not have had fair notice that his conduct was illegal.[1] Where, as in this case, an individual is not given fair notice of the requirements of the law, he necessarily lacks the requisite intent to violate the law. *Dahlstrom, supra.*

In arguing that it has met the fair notice requirement of due process, the government relies heavily upon the case *United States v. Clardy*, 612 F.2d 1139 (9th Cir. 1980). This reliance is misplaced. *Clardy* involved a deduction taken for a prepayment of interest, where the interest payment itself was accomplished through a check swap. In describing the transaction, the Ninth Circuit stated,

> There is nothing in this but an illusion. The

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[1] In a recent criminal tax fraud prosecution of Harry Margolis, Judge Aguilar granted Margolis' Rule 29 motion for acquittal at the close of the government's case. *United States v. Harry Margolis*, CR 85-2086 RPA. Once again, the government's theory was one of sham circle transfers and "worthless" check swaps. Judge Aguilar found that collateral estoppel barred the government's case. Judge Aguilar also stated, "This Court finds that as a matter of law, there is nothing illegal per se about sequential circular money transfers of the type used by the Margolis office in its tax planning...." Order on motions to dismiss, p.21. Judge Aguilar went on to find that the prosecution of Margolis violated due process under the principles set forth in *Dahlstrom*.

> prepayment of the $65,000 interest was not with any money nor with any bankable funds. It was accomplished, as the government accurately stated, by check swapping. It may be noted that, since no financial resources are required, there is no limit to the amount which can be "paid" by this technique; $650,000 is as easily "paid" as $65,000.

Clardy, supra, at 1145.

The case at bar is wholly distinguishable. Although the government challenges the *characterization* of the payments at issue here as interest, there is no allegation that the payments were illusory or not made with "real money." Moreover, the transactions involved in *Clardy* were completely devoid of economic substance whereas in this case each partnership actually acquired a real building. This case is therefore a far cry from *Clardy*, which involved "nothing...but an illusion."

Judging the indictment against the attorney-designed tax plans approved in *Stern v. CIR*, 747 F.2d 555 (9th Cir. 1984); *Roberts v. CIR*, 643 F.2d 654 (9th Cir. 1981); *Photocircuits Corp. v. United States*, 204 Ct. Cl. 821 (34 AFTR 2d 74-5211, 74-2 USTC ¶ 9558) (1974); and *Danbury, Inc. v. Anthony Olive, etc.*, 86-1 USTC CCH Fed. Tax ¶ 9223 at 83349 (January 1986), it is clear that the due process requirements of fair notice as enunciated in *Dahlstrom* require dismissal of Counts 1-20.

The lack of fair notice that the conduct charged in this case was criminal is underscored by a Settlement Plan Agreement executed by Schulman and the government in August 1983. The Settlement Plan Agreement was executed by the District Director of the Los Angeles

District of the Internal Revenue Service, the Chief of the Examination Division of the Los Angeles District, and the Chief of the Internal Revenue Service Appeals Office in Los Angeles. Under the Settlement Plan Agreement, the Internal Revenue Service agreed to permit 70% of the interest deductions at issue here to be taken by investors in the first year of acquisition of the buildings. The remaining 30% of the interest deductions were then to be deducted by the investors ratably over the term of the purchase money notes entered into by each partnership in conjunction with the acquisition of the buildings. The settlement, in turn, required Schulman to restructure his future syndication packages so that no foreign entities would be involved. The government concedes that the Settlement Plan Agreement was executed with full knowledge of the nature and substance of the transactions at issue in this case. Elam Affidavit, ¶¶ 8 and 13; Tr. at 45.

For the reasons discussed, Counts 1-20 of the First Superseding Indictment are dismissed.

III.

COUNTS 21-25

Counts 21-25 of the First Superseding Indictment charge Schulman with perjury. 18 U.S.C. §1623. Each count is based on testimony elicited in a deposition taken in the fall of 1984 in connection with a summons enforcement proceeding instituted by the Internal Revenue Service. The government has consented to the dismissal of Count 25 and Schulman did not move to dismiss Count 24.

Precise questioning is imperative as a predicate for the offense of perjury. *United States v. Cowley*, 720 F.2d 1037, 1042 (9th Cir. 1983, *cert. denied*; 465 U.S. 1029 (1984) (quoting *Bronston v. Limited Stables*, 409 U.S. 352, 362 (1973)). Therefore, a perjury count may not rest on ambiguous inquiries and evasive answers. Rather, "the burden is on the questioner to pin the witness down to the specific object of the questioner's inquiry." *Cowley, supra* at 1042.

The Ninth Circuit has adopted the following guideline set forth by the Third Circuit:

> No guessing is tolerated and the indictment must set out the allegedly perjurious statements and the objective truth in stark contrast so the claim of falsity is clear to all who read the charge.

Cowley, id.

Counts 22 and 23 must be dismissed under the rules set forth in *Cowley*. With respect to Count 22, it is unclear which books and records Schulman was referring to in his statement. Taken in context, Schulman may well have been referring only to bank statements and records concerning the loan transactions. The truth paragraph does not specify what records and statements were not provided by the defendant. Hence, the count is too ambiguous to stand. Count 23 must be dismissed because the truth paragraph does not contradict Schulman's statement. Rather, the truth paragraph simply sets forth details concerning the depositing of Parallax's checks about which the government failed to make direct inquiries.

IV.

CONCLUSION

For the reasons set forth herein,

IT IS ORDERED that,

1. Counts 1-20, 23 and 25 are dismissed.

2. Counts 21 and 24 may stand.

3. Defendant's motion for a bill of particulars is dismissed as moot.

DATED: July 30, 1986.

/s/ Mariana R. Pfaelzer
MARIANA R. PFAELZER
United States District Judge

APPENDIX E

APPENDIX E

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

No. 86-5251
D.C. No. CR-86-00253-MRP

UNITED STATES OF AMERICA,

Plaintiff-Appellant,

vs.

GERALD L. SCHULMAN,

Defendant-Appellee.

Argued and Submitted
March 2, 1987--Pasadena, California

Filed May 20, 1987

Appeal from the United States District Court
for the Central District of California
Mariana R. Pfaelzer, District Judge, Presiding

BEFORE: WALLACE, TANG and ALARCON, Circuit Judges.

TANG, Circuit Judge:

The government appeals the district court's dismissal of 23 counts of a 25-count indictment charging Schulman with conspiracy, tax fraud and perjury. The charges arose from the promotion, sale and administration of a tax shelter scheme Schulman developed, in which 91 limited partnerships purchased buildings leased to the United States Postal Service, public utilities and state governmental units, and claimed interest deductions equal to each limited partner's total capital contribution. The district court dismissed the conspiracy and tax fraud charges on the ground that the government could not prove the element of willfulness essential to convictions under 26 U.S.C. §7206(1) (making or subscribing a false tax return) and 26 U.S.C. §7206(2) (aiding in preparation and presentation of a false tax return) because the government could not show that the type of tax shelter promoted by Schulman was clearly illegal in 1978 and 1979. We reverse.

BACKGROUND

Schulman is an accountant who has done tax planning for clients since the early 1970's. He was a client of tax attorney Harry Margolis for several years beginning in 1974 and received advice about real estate tax shelters based on deductions generated by circular financing. *See, e.g, Goldberg v. United States*, 789 F.2d 1341 (9th Cir. 1986). In 1978 and 1979 Schulman created 91 real estate limited partnerships for the purpose of acquiring various public buildings to be purchased

through long-term purchase money mortgages, requiring no down payment and bearing interest at below market rates. Schulman promoted the sale of the partnership interests by representing that all money invested would be deductible on 1979 tax returns as an interest expense. Schulman was the general partner in each limited partnership.

The promised tax objective was realized through a series of financing and loan transactions between the partnerships and two foreign corporations: Hexagram, a Netherlands Antilles corporation, and Parallax, a Panamanian corporation. The corporations and the limited partnerships all had bank accounts at Banco de Iberoamerica, in Panama, and at Barclays Bank in Holland. The partnerships each secured a short-term loan from Hexagram and executed promissory notes to Hexagram bearing interest at 10%. Each partnership delivered the funds borrowed from Hexagram to Parallax under a financing agreement in which the partnership agreed not to charge any interest as consideration for Parallax's agreement to obtain favorable long-term financing for the purchase of the real estate. Parallax deposited the money in the Panamanian Bank with instructions to loan it to Hexagram. These loans and transfers thus were effected through the use of circular financing, with the same transaction being repeated 91 times in two days on October 31 and December 5, 1978; the result was that $252 million was "loaned" to the Schulman partnerships. Some twelve to fourteen months later, on December 27, 1979, the principal amount ($220 million) was repaid to Hexagram by reversing the circle using the accounts at Barclays Bank. When Parallax returned the money to each partnership, it in turn repaid Hexagram the loan plus interest. The interest payment

equaled the initial capital contribution of the partners (approximately $28 million).

There is no dispute that the limited partners made capital contributions, or that the partnerships did purchase and do own real buildings in the United States, or that some of the partnership transactions had economic substance apart from their tax consequences. The government does not argue that Schulman, the partners, or the partnerships had any ownership interest in the two foreign companies or that the companies were not duly organized under the laws of the Netherlands Antilles or Panama.

The government alleges that the loan and financing transactions between the Schulman partnerships and Hexagram and Parallax had no economic substance. There was not $252 million in cash to be loaned. Rather, there was a collected fund available for cash withdrawal of as little as one thousand dollars. The thousand dollars was circulated through the accounts until a total of $252 million was reached. Thus these transactions were mere "check swaps" which cannot be characterized as loans. Since there were no loans, the December 1979 cash payments to Hexagram, the government contends, cannot be characterized as interest payments.

The IRS began a civil audit in 1982 of the 1979 partnerships and in August 1983 reached a Settlement Plan Agreement in which the IRS agreed to permit 70% of the interest deductions to be taken in the first year of investment and the balance to be deducted over the term of the purchase money notes executed by the partnerships to acquire the leased properties. Mr. Schulman agreed to restructure future transactions so that no foreign entities

would be involved. The Service, however, abandoned the agreement in 1984 and instituted a summons enforcement proceeding in which it took Schulman's deposition.

Count I of the indictment - the conspiracy count-alleges that Schulman organized and promoted the Schulman partnerships, orchestrated the financing transactions which generated the false loans and falsely reported the payments as interest on federal tax filings. The substantive tax counts arise from the tax plan and charge that Schulman aided and assisted in preparation of false and fraudulent returns filed by the limited partnerships (Counts II-XIII) and individual partners (Counts XIV-XIX) in violation of 26 U.S.C. §7206(2) and by Schulman himself (Count XX) in violation of 26 U.S.C. §7206(1). Counts XXI-XXV charge that Schulman perjured himself while giving deposition testimony in violation of 18 U.S.C. §1623.

Schulman moved to dismiss the indictment and for a bill of particulars. The district court granted Schulman's motion to dismiss the tax fraud and conspiracy counts on the ground that the due process defense was legally sufficient because in 1978 and 1979 this type of circular financing was not clearly illegal. The district court dismissed two of the perjury counts (Counts XXII and XXIII) because the questioning had been too ambiguous. The government agreed to dismissal of Count XXV as multiplicitous.

ANALYSIS

I

Dismissal of Tax Shelter Counts

A. Standard of Review

We review the sufficiency of an indictment de novo. *United States v. Buckley*, 689 F.2d 893, 897 n. 4 (9th Cir. 1982), *cert. denied*, 460 U.S. 1086, 103 S.Ct. 1778, 76 L.Ed.2d 349 (1983).

A Rule 12(b)(1) motion to dismiss is appropriately granted when it is based on questions of law rather than fact. *United States v. Shortt Accountancy Corp.*, 785 F.2d 1448, 1452 (9th Cir.), *cert. denied*, --U.S.--, 106 S.Ct. 3301, 92 L.Ed.2d 715 (1986). Here Schulman argued that he lacked notice of the criminality of his conduct, and that this constitutional deficiency provided a complete due process defense to the charges, and that the legal defense was capable of determination without trial. The district court agreed. The court assumed all facts alleged and found them insufficient to create a triable issue of fact with regard to the due process defense. The district court relied on *United States v. Dahlstrom*, 713 F.2d 1423, 1428 (9th Cir. 1983), *cert. denied*, 466 U.S. 980, 104 S.Ct. 2363, 80 L.Ed.2d 835 (1984) in deciding that the law in 1978 and 1979 was not sufficiently clear as to the legality of the tax shelter program Schulman promoted to find Schulman had the requisite intent to violate the law. Because the district court ruled as a matter of law, we review the holding de novo. *United States v. Russell*, 804 F.2d 571, 574 (9th Cir. 1986).

B. Is Willfulness a Factual Question?

The government first argues that the district court erred in dismissing the indictment as a matter of law because the question of Schulman's willfulness is a factual question of his subjective intent, not a legal question of the objective certainty in the law. The government argues that willfulness is a question of subjective intent because when a defendant knows he is committing a wrongful act it does not matter that "there is no litigated fact pattern precisely in point." *United States v. Ingredient Technology Corp.*, 698 F.2d 88, 96 (2d Cir.) (quoting *United States v. Brown*, 555 F.2d 336, 339-40 (2d Cir. 1977), *cert. denied*, 462 U.S. 1131, 103 S.Ct. 3111, 77 L.Ed.2d 1366 (1983). The government thus insists that if a defendant has the willful intent to commit a wrongful act, but the act is not illegal as a matter of law, the indictment should be dismissed not for the failure to establish intent but because another essential element of the charged offense is missing. We need not decide the issue because even if the government is correct, we still must review the district court's determination that the tax shelter scheme Schulman promoted was not clearly illegal in 1978 and 1979.

C. Legality of Schulman's Tax Shelter

The district court dismissed the indictment because it believed *Dahlstrom*, 713 F.2d at 1428, stands for the proposition that when the legality of a tax shelter is unsettled by clearly relevant precedent an indictment must be dismissed because the requisite intent is lacking. *Dahlstrom* is more properly read as a case barring the "[p]rosecution for *advocacy* of a tax shelter program in the absence of any evidence of a specific intent to violate the

law" because such prosecution "is offensive to the first and fifth amendments." *Id.* at 1429 (emphasis added); *see also Russell*, 804 F.2d at 576 (Ferguson, J., concurring) (*Dahlstrom* "was primarily a First Amendment case involving pure advocacy"). In this case, Schulman did not merely advocate the tax shelter in question, he was involved in "orchestrating the generation of the questionable tax deduction." *United States v. Crooks*, 804 F.2d 1441, 1449 (9th Cir. 1986) (distinguishing *Dahlstrom* in a factually similar case).

Of course even in a case involving more than mere advocacy, the inquiry must be whether the law clearly prohibited the conduct alleged in the indictment. There is no dispute in this case that the law is well settled that sham transactions are illegal. *Commissioner v. Court Holding Co.*, 324 U.S. 331, 65 S.Ct. 707, 89 L.Ed. 981 (1945); *Knetsch v. United States*, 364 U.S. 361, 81 S.Ct. 132, 5 L.Ed.2d 128 (1960); *United States v. Clardy*, 612 F.2d 1139, 1151-53 (9th Cir. 1980). In *Court Holding* the Supreme Court established the fundamental doctrine that the true nature of a transaction may not "be disguised by mere formalisms, which exist solely to alter tax liabilities." 324 U.S. at 334, 65 S.Ct. at 708. The Supreme Court has also clearly held that for an interest payment to be deductible, the interest must be paid on genuine indebtedness. *Knetsch*, 364 U.S. at 365 66, 81 S.Ct. at 134-35. When there is no genuine indebtedness underlying the interest payment, the transaction is a sham. *Id.* Relying on *Knetsch* we upheld a conviction for false return information in a case of claimed deductions for interest payments because our analysis revealed "that there was no substance behind the forms employed." *Clardy*, 612 F.2d at 1152.

In this case the district court found that the transactions were not a sham because "real money" was expended, and that the transactions were not devoid of economic substance because the partnerships each acquired a real building. We believe the financing arrangement has to be evaluated separately on its own merits and cannot be found to have substance merely because the partnerships acquired real property or invest "real" money. The only question is whether there were real interest payments on genuine indebtedness. The indictment sufficiently alleges a lack of substance behind the check cycle to sustain the charges against a motion to dismiss.

The transactions in this case are similar to those we held to be a sham in *Crooks*, 804 F.2d 1441. In *Crooks* the defendant devised a tax shelter in which investors purchased interests in limited partnerships which owned coal leases and claimed deductions three times the amount of their investment for payments denominated advance mineral royalty payments. *Id.* at 1443. Because the partnerships lacked the assets to make the royalty payments they created a "check cyclone" with simultaneous, same bank transfers of checks in a circular transaction which we characterized "as borrowing money, paying oneself a royalty payment, and paying back the lender, leaving each party in the same position it was in before the transaction." *Id.* at 1443, 1449. In *Crooks* we upheld a conviction for conspiracy and filing false returns on facts similar to those alleged in the Schulman indictment. We are persuaded the allegations in this case are sufficient to withstand dismissal.

We agree with the government that the Schulman financing transactions were a sham that lacked substance

because there was no economic risk associated with the purported loans. See *Goldberg v. United States*, 789 F.2d 1341, 1343 (9th Cir. 1986) (indebtedness a sham when taxpayers do not incur "any actual economic liabilities of any substance"). Schulman does not dispute that there were no actual loans of real money in the amount of $252 million; further the government contends that the promissory notes in this case are wholly unenforceable. Assuming that contention is true there is no risk of any sort in the underlying financing transactions and the $28 million was improperly characterized as a deductible interest expense. Such a sham transaction was clearly prohibited by law in 1978 and 1979, and thus dismissal of the indictment was improper since an intent to violate the law cannot be ruled out as a matter of law.[1]

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[1] The district court's other reasons for dismissing the indictment are unsound. The court thought that the 1975 prosecution of Harry Margolis for tax fraud involving a theory of sham circle transfers, which resulted in Margolis's acquittal, would have served to make Schulman believe his activities were permissible. The government is correct in saying Schulman's knowledge and understanding of the implications of the Margolis trial is a factual question for the jury. The disposition of the Margolis case offers little guidance on the law at the time since the government of course could not appeal from the acquittal. The district court cited two other attorney designed tax plans approved by this court as a reason for dismissal of the Schulman indictment. The cases are inappropriate because they are not sham transactions cases. *See Stern v. Commissioner*, 747 F.2d 555 (9th Cir. 1984); *Roberts v. Commissioner*, 643 F.2d 654 (9th Cir. 1981). The district court also thought the government's proposed Settlement Plan entered into with Schulman constituted evidence of the legality of the tax shelters. Aside from the fact that subsequent opinions are irrelevant to an inquiry into the objective state of the law at a prior time, as the government notes, it did not have proof of the sham nature of the transactions when it entered into the agreement. Once the government obtained that evidence it cancelled the agreement.

II

Dismissal of Perjury Counts

A. Standard of Review

The legal sufficiency of a perjury indictment is reviewed de novo. *United States v. DeCoito*, 764 F.2d 690 (9th Cir. 1985).

B. Dismissal of Counts XXII and XXIII

Count XXII charged that Schulman lied when he stated "all ... the complete sets" of books and records for the partnerships had been turned over to the IRS because in truth he "well knew and believed, the complete sets of books for each partnership had not been turned over." The district court held that the truth paragraph did not specify what records and statements were not provided by the defendant, and thus the count failed to meet the standard of *United States v. Cowley*, 720 F.2d 1037, 1042 (9th Cir. 1983) *cert. denied*, 465 U.S. 1029, 1104 S.Ct. 1290, 79 L.Ed.2d 692 (1984). *Cowley* indicates an indictment must set out the "allegedly perjurious statements and the objective truth in stark contrast so that the claim of falsity is clear to all who read the charge." *Id.* (quoting *United States v. Tonelli*, 577 F.2d 194, 195 (3d Cir. 1978)). Schulman's statement was volunteered and nonresponsive to any question. In the context of his discourse on the mechanics of the partnership transactions with Parallax and Hexagram, Schulman stated that each partnership had its own set of books and that the complete sets had been turned over to the IRS. What Schulman may have meant is unclear when viewed in context, since he may have been talking only about the records called for in the

subpoena or only about the partnerships that dealt with Parallax and Hexagram. It was incumbent on the government attorney "to bring the witness back to the mark, to flush out the whole truth with the tools of adversary examination." *Bronston v. United States*, 409 U.S. 352, 358-59, 93 S.Ct. 595, 600, 34 L.Ed.2d 568 (1973). Here the attorney failed "to pin the witness down to the specific object of the questioner's inquiry." *Id.* at 360, 93 S.Ct. at 601. Because the meaning of Schulman's answer is ambiguous we agree with the district court that the truth paragraph did not stand out in stark contrast to the allegedly perjurious statement.

Count XXIII charged that Schulman lied when he denied he knew what Parallax did with the money received from the partnerships and when he said he had no firsthand knowledge of the money because Schulman himself deposited the checks into the Parallax account. The government attorney asked Schulman if he knew whether Parallax deposited the money from the partnerships. Schulman said he did not know. The government says that in truth Schulman acted for Parallax by initialing and depositing the deposit tickets and checks into the Parallax account. The government contends this contrast between the answer and the truth is sufficient for a charge of perjury. We agree with the district court that there is not a stark contrast between the statements because the government attorney did not ask questions specific enough to pin down precisely what Schulman's role had been. *Bronston*, 409 U.S. at 360, 93 S.Ct. at 600.

CONCLUSION

We conclude that, assuming the truth of the allegations in the indictment, the defendant was engaged

in promoting a tax scheme, the illegality of which he had fair notice. The district court erred in granting defendant's motion for dismissal of 20 counts. The court did not err in dismissing the two perjury counts.

AFFIRMED in part, REVERSED in part and REMANDED.

APPENDIX F

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STATUTORY PROVISION INVOLVED

26 U.S.C. §7206 (1982) provides in relevant part:

§7206. Fraud and false statements

Any person who--

> (1) Declaration under penalties of perjury.--Willfully makes and subscribes any return, statement, or other document, which contains or is verified by a written declaration that it is made under the penalties of perjury, and which he does not believe to be true and correct as to every material matter; or
>
> (2) Aid or assistance.--Willfully aids or assists in, or procures, counsels, or advises the preparation or presentation under, or in connection with any matter arising under, the internal revenue laws, of a return, affidavit, claim, or other document, which is fraudulent or is false as to any material matter, whether or not such falsity or fraud is with the knowledge or consent of the person authorized or required to present such return, affidavit, claim, or document;

shall be guilty of a felony and, upon conviction thereof, shall be fined not more than $100,000 ($500,000 in the case of a corporation), or imprisoned not more than 3 years, or both, together with the costs of prosecution.

(As amended Sept. 3, 1982, Pub. L. 97-248, Title III, §829(c), 96 Stat. 618.)

APPENDIX G

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CONSTITUTIONAL PROVISION INVOLVED

The Fifth Amendment to the Constitution of the United States provides:

> No person shall be held to answer for a capital, or otherwise infamous crime, unless on a presentment or indictment of a Grand Jury, except in cases arising in the land or naval forces, or in the Militia, when in actual service in time of War or public danger; nor shall any person be subject for the same offense to be twice put in jeopardy of life or limb;nor shall be compelled in any criminal case to be a witness against himself, nor be deprived of life, liberty, or property, without due process of law; nor shall private property be taken for public use, without just compensation.